

REPORT OF THE AUDITOR-GENERAL TO THE MUNICIPAL COUNCIL AND THE KWAZULU-NATAL PROVINCIAL LEGISLATURE ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF EDUMBE MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2007

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Edumbe Municipality which comprise the statement of financial position as at 30 June 2007, statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes as set out on pages 7 to 25.

Responsibility of the accounting officer for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the basis of accounting determined by the National Treasury, as set out in accounting policy note 1 in the financial statements and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA). This responsibility includes:
 - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
 - selecting and applying appropriate accounting policies
 - making accounting estimates that are reasonable in the circumstances.

Responsibility of the Auditor-General

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on my audit in accordance with the International Standards on Auditing. Because of the matters discussed in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis of accounting

4. The municipality's policy is to prepare financial statements on the basis of accounting determined by the National Treasury as set out in accounting policy note 1 to the financial statements.

Basis for disclaimer

5. The failure to provide sufficient and appropriate audit evidence, satisfactory information and explanations, and working papers for numerous transactions and balances in the financial statements limited the scope of the audit. In this regard, the municipality's records did not permit the application of alternative audit procedures to substantiate the applicable financial statement assertions in respect of these transactions and balances.

5.1 Property, plant and equipment

The existence, completeness and valuation of property, plant and equipment totalling R34,5 million as disclosed in note 5 to the financial statements could not be verified due to the following:

5.1.1 Asset register issues

- a) The asset register produced was not up-to-date.
- b) Explanations could not be provided for a difference of R58 128, which existed between the asset register and valuation roll amounts.

5.1.2 Opening balances

An unexplained discrepancy of R25 million was identified in note 5, between the closing balance of the prior year and the opening balance of the current year for property, plant and equipment.

5.1.3 Impairment not performed

Management did not perform impairment tests on property, plant and equipment for the year under review. Furthermore, the municipality's accounting policy did not include information regarding the subsequent measurement, impairment and periodic reviews of the useful life of its assets. This is contrary to Generally Accepted Municipal Accounting Practice (GAMAP) 17 (Property, plant and equipment).

5.1.4 Ownership cannot be established

Title deeds for land and buildings to the value of R4,7 million and R11,1 million respectively, could not be produced in order to assess whether the municipality had rights to these assets.

5.1.5 Depreciation incorrect

An unexplained difference of R205 990 existed between the amount of depreciation as per note 5 and as per appendix B to the financial statements.

5.1.6 Heritage assets not disclosed

Heritage assets in the amount of R19 million were accounted for in the prior years financial statements. However, no accounting policy for the recognition and measurement was in place and the municipality did not record these assets separately in the current year.

5.1.7 Investment property not identified

Investment property and owned items of property, plant and equipment were not specified in the financial statements, as required by GAMAP 17 and International Accounting Standard IAS 40 (AC135)(Investment property). In this regard, the asset register reflected land and buildings to the value of R15,8 million, in the name of the municipality.

5.1.8 Landfill site not disclosed

Municipal landfill sites were not valued and accounted for in the financial statements.

5.1.9 Operating lease assets not identified

The municipality did not include accounting policies for leased assets nor distinguish between owned and leased assets in the financial statements. However, it was noted that the municipality had operative lease agreements in place. Moreover, transactions and balances for leases could not be validated, due to the failure to provide supporting documents in this regard.

5.2 Investments

5.2.1 Receivables and payables not measured at fair value

Current assets of R20,7 million and current liabilities of R8,4 million have not been recognised or measured in terms of IAS 39 (AC133)(Financial Instruments: Recognition and Measurement) nor disclosed in terms of IAS 32 (AC125)(Financial Instruments: Presentation and Disclosure). In this regard, the municipality would have to determine the discounting period as well as an adequate discount rate in accordance with its risk profile, to ensure that receivables and payables are fairly valued.

5.2.2 Call accounts not recognised as held-to-maturity financial assets

Short-term call account bank balances totalling R9,5 million, as disclosed in note 9 to the financial statements had not been accounted for as held-to-maturity financial assets in accordance with the measurement provisions of paragraph 43 and 46(b) of IAS 39.

5.3 Receivables

5.3.1 Unexplained differences

An unexplained difference of R4,4 million existed between the aging analysis and the financial statement amounts. The municipality's records did not permit the application of alternative auditing procedures, hence, sufficient and appropriate evidence on the measurement and completeness of receivables could not be obtained.

5.4 Bank balances

5.4.1 Bank reconciliations not performed

No monthly bank reconciliations were performed for the year under review. Consequently, it was not possible to determine whether the cashbook reconciled to the bank statements on a monthly basis. In this regard, the following differences were noted:

- a) An unexplained difference of R1,3 million existed between the cashbook balance in the bank reconciliation and the financial statements.
- b) Cash balances and expense transactions were misstated due to stale cheques amounting to R177 500 dating back to September 2006 not being written back.

5.5 Presentation (reserves)

5.5.1 Capitalisation reserve

Reserves, which were previously utilised for the purchase of property, plant and equipment, were not recognised in the capitalisation reserve in terms of the prescribed accounting policy.

5.5.2 Government grant reserve

No amounts were recorded in the government grant reserve for assets that were financed from government grants.

5.5.3 Statutory funds and reserves

The statement of changes in net assets did not separately reflect statutory funds, distributable, revaluation and other reserves.

5.5.4 Non-distributable reserves

Non-distributable reserves amounting to R29,4 million had not been accounted for as a retrospective change in accounting policy in accordance with GRAP 1, paragraph 19(b) and GAMAP 17, paragraph 85.

5.6 Revenue

5.6.1 Revenue not complete

The completeness and measurement of recorded revenue for rates and service charges totalling R16 million, as per the statement of financial performance could not be adequately verified as a result of the following:

- a) An updated valuation roll could not be provided on request.
- b) A detailed service transaction listing as well as a listing of new service connections could not be provided on request.
- c) Water and electricity distribution losses were not disclosed separately in the financial statements. Furthermore, reconciliations and evidence of monitoring could not be produced.

5.6.2 Grant income not complete

The completeness and measurement of grants totalling R15 million, as per note 11 to the financial statements could not be adequately verified due to the following:

- a) A register of grants was not maintained.
- b) Reconciliations of grants to the general ledger were not performed.
- c) The source of the grant could not be easily verified due to insufficient details on the bank statements.

- d) No evidence of communication or correspondence was maintained with/from the transferor of the grants.

5.7 Expenditure

5.7.1 Sufficient and appropriate evidence not provided

The completeness, accuracy and validity of expenditure totalling R34,2 million as recorded in the statement of financial performance could not be validated due to the following weaknesses:

- a) Supporting documentation for expenditure totalling R4,6 million could not be produced.
- b) Cheque payment vouchers totalling R1,7 million could not be traced to the general ledger.
- c) Supporting documentation for purchase orders totalling R1,5 million could not be produced.

5.8 Employee benefits

5.8.1 Sufficient and appropriate evidence not provided

The completeness and measurement of salaries and wages totalling R12,4 million as disclosed in note 12 to the financial statements could not be sufficiently relied upon due to the following:

- a) No payroll printouts were produced from September 2006 to June 2007 for payments totalling R4,2 million.
- b) Payroll printouts from March to June 2007 were not reviewed by senior management.
- c) There was no evidence of an analysis of payments to third parties.
- d) Supporting documentation could not be produced for payments totalling R1,3 million made to third parties.

5.9 Value-Added-Tax (VAT)

5.9.1 Reconciliations not performed and lack of records

VAT reconciliations were not performed during the year under review. Moreover, no documentation could be provided to support the VAT debtor balance of R1 million as disclosed in the financial statements.

5.10 Provisions

The completeness and accuracy of provisions totalling R1,7 million as disclosed in the statement of financial position could not be verified due to the following:

5.10.1 .Provisions not correctly accounted for

- a) Provisions were not discounted to fair values, as required by GAMAP 19 (Provisions, contingent liabilities and contingent assets).
- b) The disclosure requirements for provisions as embodied in GAMAP 19, paragraphs 95 to 106 were not complied with.
- c) The audit fee provision of R332 533 should have been recorded as an accrual.
- d) Leave pay was not provided for, as required by GAMAP 19.
- e) A provision for the restoration and rehabilitation of landfill sites was not provided for.

5.11 **Related parties**

5.11.1 Related parties not disclosed

Related parties and transactions were not disclosed in the financial statements as required by IAS 24 (AC126). Moreover, policies and procedures were not developed by management to ensure that related parties and transactions were identified.

5.12 **Capital commitments**

5.12.1 Capital commitments not disclosed

The financial statements did not disclose any capital commitments and management did not maintain any records and contract registers in this regard. Consequently, it was not possible to determine whether the financial statements were fairly presented for commitments.

5.13 **Financial statements**

5.13.1 **Financial statement errors**

Numerous errors were identified in the financial statements, which had not been rectified. Moreover, instances were noted whereby required presentation and disclosures were not made in terms the GRAP Framework for the preparation and presentation of financial statements, as issued by the Accounting Standards Board, as well as in terms of the specimen financial statements requirements of June 2005 issued by the National Treasury. The deficiencies are recorded below:

- a) The basis of presentation did not include all the applicable GRAP and GAMAP standards.
- b) The accounting officer's report was not included in the financial statements.
- c) There was no disclosure of remuneration of the municipal manager and chief financial officer in note 13 to the financial statements.

- d) The annexure for grants and subsidies (receipt and expenditure) was not disclosed.
- e) Consumer deposits totalling R161 557 in respect of electricity and water was incorrectly included as long-term liabilities.
- f) The VAT debtor balance of R1 million, as per note 4 was incorrectly disclosed as a current liability.
- g) Suspense accounts totalling R3,6 million were not cleared at year end. Moreover, a full analysis of this amount could not be provided.
- h) There was an unexplained difference of R340 581 between the accumulated surplus in the statement of changes in net assets and the statement of financial position.
- i) There was an unexplained difference of R8,6 million between the financial statements and the trial balance for various balances.
- j) There was an unexplained difference of R2,3 million between the statement of financial performance and the applicable notes for various transactions.
- k) There was an unexplained difference of R79 660, in that, the total debits (R99,839 million) and credits (R99,759 million) did not match on the trial balance.

5.13.2 Non-compliance with financial reporting framework

Attention is drawn to note 19.1 for the item regarding the inclusion of budget information in the financial statements. In accordance with GRAP 1, paragraph 11, entities that are typically subject to budgetary limits in the form of budget authorisations, which is given effect through authorising legislation, are required to disclose budget information. Although, the said note referred to the inclusion of budget information for the current year, no such information had been presented in the financial statements.

5.14 Prior year's financial statements qualified – not resolved

The prior period non-compliance with the applicable financial reporting framework resulted in a qualification of the prior period's audit opinion, which has still not being rectified in the current period.

Disclaimer of opinion

- 6. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have been unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements of Edumbe Municipality. Accordingly, I do not express an opinion on the financial statements.

OTHER MATTERS

I draw attention to the following matters that are ancillary to my responsibilities in the audit of the financial statements:

7. Non-compliance with applicable legislation

7.1 Municipal Finance Management Act

The following instances of non-compliances with MFMA that were noted:

- a) The financial statements were not submitted for auditing within two months after year end, as required by section 126(1)(a).
- b) There was no fraud prevention or risk management policy in place, as required by section 62(1)(a)(i).
- c) The recommendations made by the Auditor-General in the prior year's reports have not been fully implemented, which is in contravention of section 131(1).
- d) The quarterly management expenditure report was not submitted to the provincial treasury, as required by section 71(1).
- e) There was no investment and cash management policy in place, as required by section 13(2).
- f) There was no revenue and credit management policy in place, as required by section 64.
- g) There was no expenditure management policy in place during the year, as required by section 65.
- h) There was no inventory and asset management policy in place, as required by section 63. Moreover, there was inadequate security measures in place for the safeguarding of assets, as required by section 63(1).
- i) The prior year fruitless and wasteful expenditure was neither disclosed nor raised as debtor, as required by section 125(2)(d).
- j) There was no policy of delegation of powers to ensure that authority and responsibilities, as well as reporting relationships were established, as required by section 162.

7.2 Municipal Systems Act

The following instances of non-compliances with the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) were noted:

- a) No framework was in place to assist with monitoring of the budget, strategic plans and business risk.
- b) The municipality had not developed or adopted appropriate systems and procedures to ensure fair, efficient, effective and transparent personnel administration that addressed the following:
 - The recruitment, selection and appointment of persons as staff members.
 - The monitoring, measuring and evaluating of performance of staff members.
- c) There was no contingency and fraud prevention plan in place.
- d) The responsibilities of different levels of management and their roles in decision-making were not documented and communicated to all staff.
- e) There was no performance contract between the accounting officer and the executive committee.

8. Matters of governance

8.1 Audit committee not functional

No audit committee function was in operation for the year under review. Consequently, oversight mechanisms were not in place to enhance the integrity of financial reporting and perform an assessment of the effectiveness of the internal audit function.

8.2 Risk assessments not performed

Management did not perform risk assessments neither was a policy developed to manage risks impacting on the municipality. Consequently, management was unable to identify potential threats and opportunities to fully promote the overall well-being of the municipality.

9. Internal control

Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes of the matters indicated, as they relate to the five components of internal control. In some instances deficiencies exist in more than one internal control component.

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
Basis for disclaimer of opinion					
Property, plant and equipment	✓	✓	✓	✓	✓
Investments	✓	✓	✓	✓	✓
Disclosure	✓		✓	✓	✓
Receivables and payables	✓		✓	✓	✓
Provisions	✓	✓	✓	✓	
Revenue and bank	✓	✓	✓	✓	✓
Expenses	✓	✓	✓	✓	✓
VAT	✓	✓	✓	✓	✓
Employee benefits	✓	✓	✓	✓	✓
Other matters					
Non-compliance with applicable legislations	✓	✓	✓	✓	✓
Matters of governance	✓	✓	✓	✓	✓

OTHER REPORTING RESPONSIBILITIES

Reporting on performance information

10. I was engaged to review the performance information.

Responsibility of the accounting officer for the performance information

11. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

Responsibility of the Auditor-General

12. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 646 of 2007*, issued in *Government Gazette No. 29919 of 25 May 2007* and section 45 of the MSA.
13. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.
14. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the findings reported below.

Findings (performance information)

15. Non-compliance with regulatory requirements

The municipality has not reported performance against predetermined objectives, as required by section 40 of the MSA.

APPRECIATION

16. The assistance rendered by the staff of the Edumbe Municipality during the audit is sincerely appreciated.

Pietermaritzburg

27 April 2008



A U D I T O R - G E N E R A L